

*LaPine Technology Corp. v. Kyocera Corp.**

I. INTRODUCTION

Some parties are placing clauses in their arbitration agreements providing for heightened judicial scrutiny of arbitration awards in an effort to safeguard against factual or legal errors made by arbitrators.¹ However, debate has arisen as to whether federal courts have the jurisdiction to review arbitration decisions on a heightened basis because the Federal Arbitration Act (FAA),² which sets forth substantive rules governing arbitration, provides for narrow review.³ In *LaPine Technology Corp. v. Kyocera Corp.*,⁴ the Ninth Circuit Court of Appeals, reversing the Northern District of California,⁵ held that courts may review arbitration awards with scrutiny exceeding the standard of review set forth in the FAA when the parties agree to such heightened scrutiny. In reversing the district court's decision, the Ninth Circuit joins the Fifth Circuit;⁶ however, the Seventh Circuit has indicated that it would hold that courts have no jurisdiction to review arbitration awards when the standard of review would exceed the standard provided for in the FAA.⁷ This represents a split of authority in the circuit courts that may prompt the Supreme Court to review this issue.

* 130 F.3d 884 (9th Cir. 1997).

¹ The American Law Institute–American Bar Association Continuing Legal Education (ALI-ABA) Course of Study provides an example of such a clause:

Upon application by either party to a court for an order confirming, modifying or vacating the award, the court shall have the power to review (a) whether the findings of fact rendered by the arbitrator(s) are supported by substantial evidence and (b) whether, as a matter of law based on such findings of fact, the award should be confirmed, modified or vacated. Upon such determination, judgment shall be entered in favor of either party consistent herewith.

Stephen A. Hochman, *Alternative Dispute Resolution: How to Use it to Your Advantage—Model Dispute Resolution Provisions for Use in Commercial Agreements Between Parties with Equal Bargaining Power*, SB41 ALI-ABA 153, 180 (1996).

² 9 U.S.C. § 1 *et seq.* (Supp. 1995).

³ See 9 U.S.C. § 10(a)(1)–(4) (Supp. 1995).

⁴ 130 F.3d 884 (9th Cir. 1997).

⁵ See 909 F. Supp. 697 (N.D. Cal. 1995).

⁶ See *Gateway Tech., Inc. v. MCI Telecomm. Corp.*, 64 F.3d 993 (5th Cir. 1995).

⁷ See *Chicago Typographical Union v. Chicago Sun-Times, Inc.*, 935 F.2d 1501 (7th Cir. 1991).

II. JUDICIAL REVIEW UNDER THE FEDERAL ARBITRATION ACT

The rules of the FAA provide for limited judicial review of arbitration awards. According to the FAA, a federal court may not vacate an award unless "(1) the award was procured by corruption, fraud, or undue means; (2) there is evidence of partiality or corruption among the arbitrators; (3) the arbitrators were guilty of misconduct which prejudiced the rights of one of the parties; or (4) the arbitrators exceeded their powers."⁸ This standard of review has been described as "extraordinarily narrow."⁹ By the letter of the statute, arbitrators have sole discretion over factual determinations and legal findings in the absence of misconduct. Although § 10(a) of the FAA provides that courts may vacate arbitration awards only under the four circumstances listed above, courts at both the federal and state level have expanded the scope of review in order to vacate an arbitration award that is "(1) in 'manifest disregard' of the law, (2) in conflict with a strong 'public policy,' (3) 'arbitrary and capricious' or 'completely irrational' or (4) fails to 'draw its essence' from the parties' underlying contract."¹⁰ Even though courts have expanded judicial review beyond the limited grounds provided by the FAA, parties are rarely successful in getting a court to vacate arbitration awards on these judicially created bases.¹¹ Thus, some parties participating in arbitration are placing clauses in their arbitration agreements providing for heightened judicial scrutiny in order to protect against arbitral error that does not fall within the statutory or judicial categories.

III. PRIOR APPELLATE COURT CASES DISCUSSING WHETHER FEDERAL COURTS MAY REVIEW ARBITRATION AWARDS ON A HEIGHTENED BASIS

A. Gateway Technologies, Inc. v. MCI Telecommunications Corp.¹²

⁸ *Gateway Tech.*, 64 F.3d at 996 (citing 9 U.S.C. § 10(a)(1)–(4) and *Forsythe Int'l, S.A. v. Gibbs Oil Co.*, 915 F.2d 1017, 1020 (5th Cir. 1990)).

⁹ *Antwine v. Prudential Bache Sec., Inc.*, 899 F.2d 410, 413 (5th Cir. 1990).

¹⁰ Stephen A. Hochman, *Judicial Review to Correct Arbitral Error—An Option to Consider*, 13 OHIO ST. J. ON DISP. RESOL. 103, 110 (1997).

¹¹ *See id.*

¹² 64 F.3d 993 (5th Cir. 1995).

In *Gateway Technologies*, MCI Telecommunications (MCI) moved to vacate an arbitral decision that awarded attorneys' fees and \$2,000,000 in punitive damages to Gateway Technologies, Inc. for breach of contract.¹³ The Fifth Circuit held that a federal court has jurisdiction to review an arbitration award on a heightened basis, upholding a clause stating that the arbitration award "shall be final and binding on both parties, except that errors of law shall be subject to appeal."¹⁴ The Fifth Circuit based its decision on the reasoning set forth in *Mastrobuono v. Shearson Lehman Hutton, Inc.*,¹⁵ where the Supreme Court stated that the FAA does not prohibit a court from enforcing arbitration agreement rules that differ from those provided by the FAA.¹⁶ Thus, the *Gateway Technologies* district court committed error by not reviewing the errors of law on a de novo basis, which was the standard of review intended by the parties.¹⁷

B. Chicago Typographical Union v. Chicago Sun-Times, Inc.¹⁸

This case was an appeal by the Chicago Typographical Union challenging an arbitration award favorable to Chicago Sun-Times, Inc.¹⁹ The Seventh Circuit held that the union's appeal was frivolous because the court had no authority to review the soundness of an arbitration award absent arbitrator misconduct.²⁰ In other words, a court has no jurisdiction to review an arbitration award on a heightened basis and must follow the rules for review set forth in the FAA. The Seventh Circuit indicated that it

¹³ *See id.* at 995.

¹⁴ *Id.* at 996.

¹⁵ 514 U.S. 52 (1995).

¹⁶ The Supreme Court made the following pronouncement about arbitration agreements that provide rules governing the course of the arbitration that differ from those of the FAA:

It does not follow that the FAA prevents the enforcement of agreements to arbitrate under different rules than those set forth in the Act itself. Indeed, such a result would be quite inimical to the FAA's purpose of ensuring that private agreements to arbitrate are enforced according to their terms.

Gateway Tech., 64 F.3d at 996 (quoting *Mastrobuono*, 514 U.S. at 56).

¹⁷ *See id.* at 997.

¹⁸ 935 F.2d 1501 (7th Cir. 1991).

¹⁹ *See id.* at 1503.

²⁰ *See id.* at 1506.

would not enforce a clause in an arbitration agreement that provided for expanded judicial review of an arbitration decision.²¹ The court stated that parties "cannot contract for judicial review of that award; federal jurisdiction cannot be created by contract."²² According to the Seventh Circuit, the only measure that parties may take to protect against arbitral error is contracting for review by an appellate arbitration panel.

IV. *LAPINE TECHNOLOGY*—FACTS AND PROCEDURAL HISTORY

LaPine Technology Corp. (LaPine) instituted proceedings against Kyocera Corp. (Kyocera) in federal district court claiming breach of contract after Kyocera refused to sell computer disk drives to LaPine after agreeing to do so on November 14, 1986.²³ Kyocera then moved to compel arbitration pursuant to section 8.10(d) of the parties' agreement,²⁴ which the court granted. A panel of three arbitrators (the Tribunal) heard the dispute and issued a final decision on August 24, 1994.²⁵ Three months later Kyocera filed a Motion to Vacate, Modify and Correct the Arbitral Award claiming that: "(1) The Tribunal's findings of fact were not supported by substantial evidence, (2) the Tribunal had made errors of law, and (3) there existed various statutory grounds for vacatur or modification under the FAA."²⁶

²¹ See *id.* at 1504.

²² *Id.*

²³ See *LaPine Tech. Corp. v. Kyocera Corp.*, 130 F.3d 884, 886 (9th Cir. 1997).

²⁴ The parties' arbitration agreement included the following clause:

(d) Manner. A party desiring to submit a matter to arbitration shall give written notice to the other parties hereto The arbitrators shall decide the matters submitted based upon the evidence presented, the terms of this Agreement, the Agreement in Principle and the laws of the State of California. The arbitrator shall issue a written award which shall state the bases of the award and include detailed findings of fact and conclusions of law. The United States District Court for the Northern District of California may enter judgment upon any award, either by confirming the award or by vacating, modifying or correcting the award. The Court shall vacate, modify or correct any award: (i) based upon any of the grounds referred to in the Federal Arbitration Act, (ii) where the arbitrators' findings of fact are not supported by substantial evidence, or (iii) where the arbitrators' conclusions of law are erroneous.

Id. at 886–887.

²⁵ See *id.* at 887.

²⁶ *Id.*

In denying Kyocera's motion to vacate, the district court held that it would not follow the clause in the arbitration agreement providing for heightened scrutiny, reasoning that the district court only had jurisdiction to consider the grounds for vacatur listed in the FAA.²⁷ Using the standard of review set forth in the FAA, the district court found no basis for vacating the Tribunal's award and thus confirmed the award.²⁸ Kyocera appealed this decision to the Ninth Circuit Court of Appeals.²⁹ The Ninth Circuit framed the issue as whether "federal court review of an arbitration agreement [is] necessarily limited to the grounds set forth in the FAA or can the court apply greater scrutiny, if the parties have so agreed?"³⁰ The Ninth Circuit answered "no" to the first question and "yes" to the second, thereby reversing the district court.³¹

V. THE NINTH CIRCUIT'S DISCUSSION OF THE ENFORCEABILITY OF CLAUSES EXPANDING JUDICIAL REVIEW OF ARBITRATION AWARDS

The Ninth Circuit based its holding on the principle that the underlying purpose of the FAA is to guarantee that courts will enforce private agreements to arbitrate³² and allow parties to determine the guidelines for their arbitrations.³³ The court stated that "[a]rbitration under the Act is a matter of consent, not coercion, and parties are generally free to structure their arbitration agreements as they see fit."³⁴ In support, the Ninth Circuit cited several Supreme Court cases that stand for the proposition that courts may enforce clauses in arbitration agreements that differ from the rules set forth in the FAA.³⁵

²⁷ See *id.*

²⁸ See *id.*

²⁹ See *id.* at 888.

³⁰ *Id.*

³¹ See *id.*

³² Congress enacted the FAA in order to ensure that courts would enforce private agreements that designated arbitration as the mechanism for dispute resolution. The legislation stems from the courts' refusal to enforce such agreements. See *id.* (citing *Volt Info. Sciences v. Board of Trustees*, 489 U.S. 468, 474 (1989)).

³³ See *id.*

³⁴ *Id.* (quoting *Mastrobuono*, 514 U.S. at 56).

³⁵ See, e.g., *Mastrobuono*, 514 U.S. at 56 (enforcing an arbitration clause calling for arbitration of punitive damages despite contrary state law); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942 (1995); *Mitsubishi Motors Corp. v. Soler*

The court wholeheartedly agreed with the Fifth Circuit's decision in *Gateway Technologies*, which held that federal courts do not supersede their jurisdiction by reviewing arbitration awards on a heightened basis when the parties have agreed to such expanded review.³⁶ Quoting from *Gateway Technologies*, the Ninth Circuit made the following statement: "As [the Fifth Circuit] wisely put it: 'Because these parties contractually agreed to expand judicial review, their contractual provision supplements the FAA's default standard of review and allows for de novo review of issues of law embodied in the arbitration award.'"³⁷ The Ninth Circuit also agreed with the Fifth Circuit's reasoning that refusal to review an arbitral award on a heightened basis as provided by the parties' agreement is contrary to federal arbitration policy.³⁸ According to the court, to hold that a federal court lacked jurisdiction to review an award with greater scrutiny than dictated by the FAA "would turn the FAA on its head"³⁹ because the purpose of enacting the legislation was to guarantee that parties' agreements to arbitrate would be enforceable in court.⁴⁰

The Ninth Circuit dismissed the Seventh Circuit's pronouncement in *Chicago Typographical Union* that parties "'cannot contract for judicial review of [an] award'"⁴¹ as dicta that did not relate to the holding of that case.⁴² The court gave the following explanation as support for its conclusion that it was correct and the Seventh Circuit was wrong: "if [the Seventh Circuit] intended to refer to the FAA as a jurisdictional statute, it would have been negating the established principle that the FAA is a regulation of commerce rather than a limitation on or conferral of federal

Chrysler-Plymouth, Inc., 473 U.S. 614, 628 (1985) (enforcing arbitration clauses limiting what issues may be submitted to arbitration).

³⁶ See *LaPine Tech.*, 130 F.3d at 889.

³⁷ *Id.* (quoting *Gateway Tech.*, 64 F.3d at 996).

³⁸ See *id.*

³⁹ *Id.*

⁴⁰ Before Congress enacted the FAA, courts refused to enforce arbitration agreements because they were wary of whether arbitrators "'possess[ed] adequate means of giving redress.'" *Id.* (quoting *Red Cross Line v. Atlantic Fruit Co.*, 264 U.S. 109, 121 (1924)). The courts' apprehension about the adequacy of arbitration decisions led them to refuse to enforce agreements to arbitrate. See *id.* (citing *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 503 U.S. 265, 271 (1995)).

⁴¹ *Id.* at 890 (quoting *Chicago Typographical Union*, 935 F.2d at 1504).

⁴² See *id.*

court jurisdiction.”⁴³ Finding no grounds for holding that federal courts cannot review an arbitral award on a heightened basis, the court decided to review the Tribunal’s award for substantial evidence and errors of law, as provided by the parties’ agreement.⁴⁴

Although the Ninth Circuit admitted that having a court enforce clauses providing for the scope of judicial review was not the same as enforcing clauses limiting the scope of the issues subject to arbitration or agreements to arbitrate, the court reconciled these differences: “[T]he standards against which the work of the arbitrator will be measured are inexorably intertwined with the arbitration’s scope, affect its whole structure, and may even encourage the arbitrator to adhere to a high standard of decisionmaking.”⁴⁵ Thus, the court concluded that there was “no sufficient reason to pay less respect to the review provision than we pay to the myriad of other agreements which the parties have been pleased to make.”⁴⁶

VI. ANALYSIS

Although the Seventh Circuit indicated that it would hold the other way, *LaPine Technology* may prompt other circuit courts faced with the issue to join the Fifth and Ninth Circuit’s holdings that federal courts have the authority to exceed the standard of review provisions set forth in the FAA. Before the Ninth Circuit ruled, at least one commentator predicted that the Northern District of California would be reversed, calling the district court’s decision in *LaPine Technology* an “aberration.”⁴⁷ Apparently, commentators shared the sentiments expressed in *LaPine Technology* and believed that the better argument on this issue was that parties agreeing to arbitration can contract for any provision they want, including a provision establishing the scope of review to which the award will be subjected.

The Ninth Circuit’s opinion focused on the idea that arbitration is a creature of contract.⁴⁸ Without discussing the desirability of including

⁴³ *Id.*

⁴⁴ *See id.*

⁴⁵ *Id.* at 889.

⁴⁶ *Id.*

⁴⁷ Hochman, *supra* note 10, at 109.

⁴⁸ *See LaPine Tech.*, 130 F.3d at 888.

clauses providing for expanded judicial review in arbitration agreements, the court decided that failing to enforce *any* of an arbitration agreement's clauses would interfere with the intent of the parties.⁴⁹ Because the FAA contains no specific language stating that the narrow standard of review provided by the statute precludes more expansive review, the court interpreted the review provision of the FAA as a default standard that can be altered by contract.⁵⁰ This interpretation is consistent with the Supreme Court's statement in *Volt Information Sciences, Inc. v. Board of Trustees*,⁵¹ that "[t]here is no federal policy favoring arbitration under a certain set of procedural rules; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate."⁵² It only makes sense that parties may contract for any provision they deem appropriate as long as it is not contrary to law; therefore, the Ninth Circuit reached the correct result in *LaPine Technology*.

After *LaPine Technology*, it is clear that parties within the Ninth and Fifth Circuits' jurisdiction will have the freedom to contract for expanded judicial review in their arbitration agreements; however, the question that remains unanswered is whether such clauses will have a negative or positive impact on the effectiveness of arbitration as a means of alternative dispute resolution. Giving parties the power to contract for full judicial review of an arbitral award may undermine some of the advantages that arbitration presents.⁵³ Many parties choose arbitration not only because it is often more efficient and less expensive than traditional litigation, but also because of the finality of the award.⁵⁴ If parties contract for full judicial review, the finality of the award may no longer exist, and the trial courts will become appellate courts to parties dissatisfied with the result of the arbitration.⁵⁵ This would undermine the efficiency of arbitration—"rather

⁴⁹ See *id.* at 889.

⁵⁰ In *Gateway Technologies*, the Fifth Circuit noted that the FAA would govern review of the arbitration in the absence of a clause providing for expanded review, but the parties could contract for greater review than the review provided by the FAA. See *Gateway Tech.*, 64 F.3d at 997 n.3.

⁵¹ 498 U.S. 468 (1989).

⁵² *Id.* at 469.

⁵³ See Hochman, *supra* note 10, at 106.

⁵⁴ See *id.* at 104.

⁵⁵ See *id.* at 119.

than getting arbitration instead of litigation, the parties end up with arbitration *and* litigation.”⁵⁶

Although enforcing clauses providing for heightened review of arbitrators’ decisions may have the effect of slowing down the dispute resolution process, the power of parties to contract for review beyond the scope provided in the FAA is a benefit that outweighs this potential drawback. If parties know that courts will enforce scope of review clauses, they may be more willing to participate in arbitration because they would not be stuck with arbitral error that does not rise to the level of misconduct needed before a court can vacate an award under the FAA.⁵⁷ Allowing a full judicial review of an arbitral award may not be as efficient as limiting the scope of review to the grounds set forth in the FAA; however, as *LaPine Technology* emphasized, the parties are fully cognizant of the possibility that the award may not be final because they contracted for the expanded review.⁵⁸ The parties can decide for themselves whether they think their arbitration agreements should provide for heightened judicial review, instead of being told that scope of review cannot be a bargained-for term. *LaPine Technology* gives parties the freedom to contract for whatever scope of review they desire (i.e., review of factual findings, errors of law or both).

It should be noted that the Ninth Circuit decided that the scope of review clause at issue in that case was entitled to enforcement because federal arbitration policy mandated it, not because the court thought full judicial review was a good idea.⁵⁹ According to Stephen Hochman, full

⁵⁶ *Id.* at 110.

⁵⁷ Stephen Hochman made the following assessment regarding the use of arbitration among parties to commercial agreements:

[B]ecause of . . . the lack of an effective means of judicial review to correct arbitral error, there are many who avoid using AAA [American Arbitration Association] pre-dispute arbitration clauses in their agreements because they have no confidence that the arbitrators’ decision will be as objective, predictable and correct as one would expect if the decision were made by a highly respected judge sitting without a jury.

Id. at 104.

⁵⁸ See *LaPine Tech.*, 130 F.3d at 889. The Ninth Circuit stated that “[f]ederal courts can expand their review of an arbitration award beyond the FAA’s grounds, when (but only to the extent that) the parties have so agreed.” *Id.*

⁵⁹ See *id.*

judicial review may not be very wise.⁶⁰ He suggests that parties take a "middle ground" by providing limited judicial review in their arbitration agreements to correct only errors of law and not factual findings, because no matter what standard the court uses to review the factual findings of the arbitrator, the cost and delay of such review would be a burden that "may well outweigh its benefits."⁶¹ Therefore, although *LaPine Technologies* permits full judicial review, it may not be in the parties' best interests to contract for such an expansive review provision.

VII. CONCLUSION

LaPine Technology stands for the proposition that because arbitration is a creature of contract, parties are free to set the rules for their arbitration, and courts will enforce those rules. Parties who have been frustrated by the narrow review provision set forth in the FAA will rejoice in this holding, and it may encourage more people to include scope of review clauses in their arbitration agreements. However, this issue is far from decided because only the Fifth and Ninth Circuits have held that such clauses are enforceable, and the Seventh Circuit has indicated that the FAA prohibits them. Thus, this issue will need to be examined by the Supreme Court before parties to arbitration agreements can rest assured that clauses providing for heightened judicial review will be enforced by the federal courts.

Even if the Supreme Court agreed with the Fifth and Ninth Circuits, the question of whether such clauses are good for arbitration remains unanswered. While providing for expanded judicial review may keep arbitrators on their toes, it may lead to a decline in arbitration because the parties would rather go ahead and litigate if they know that the matter may end up in court anyway. On the other hand, if parties are not allowed to alter the scope of review, they may shy away from arbitration for fear that there would be no relief from some erroneous arbitral awards. Thus, it should be left up to the parties to decide whether they want to expand the scope of review and that is exactly what *LaPine Technologies* permits.

Rachel C. Corn

⁶⁰ See Hochman, *supra* note 10, at 119-120.

⁶¹ *Id.* at 120.